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SUBJECT: KAZAKHSTAN: PRESIDENT NAZARBAYEV CONVENES FOREIGN
INVESTORS COUNCIL

REF: (A) ASTANA 1868 (B) SECSTATE 134459

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11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: On December 5, President Nazarbayev chaired the biannual Foreign Investors Council in Almaty, which was attended by the entire Cabinet and the top 15 foreign investors in Kazakhstan. The meeting was notable for its exclusive focus on local-content, concern about the global financial crisis, and Nazarbayev's sharp, public criticism of both foreign and domestic companies, including national oil company KazMunaiGaz. Several Western company attendees said they had never before seen Nazarbayev so determined to take action to solve a problem. He ordered that an independent committee be established immediately to increase local-content and warned that even existing contracts could be revised to increase local-content requirements. END SUMMARY.

THE FOREIGN INVESTORS COUNCIL

13. (SBU) The Foreign Investors Council (FIC) meets twice annually in different cities of Kazakhstan and provides an open forum for the country's largest foreign investors, as well as international financial institutions such as the European Bank for Reconstruction and Development (EBRD), to discuss the investment climate with the President and his Cabinet. Usually, 15 foreign investors and 15 government officials attend the FIC forum.

14. (SBU) U.S. companies Philip Morris, Chevron, ExxonMobil, ConocoPhillips, AES, and General Electric regularly attend, as do other major foreign investors, primarily from the oil and gas, mining, and transportation sectors. President Nazarbayev chairs the meeting, which is dedicated to a single topic of general interest. On December 5, the government delegation read like a Who's Who of Kazakhstan's political elite: Prime Minister Masimov, Minister of Finance Korzhova, Minister of Energy Mynbayev, Central Bank Chairman Saidenov, Samruk-Kazyna Chairman Kelimbetov and Deputy Chairmen Kulibayev and Dunayev, and KazMunaiGas (KMG) President Kabyldin, among others.

15. (SBU) According to Stephen Wermert, Kazakhstan Country Director for the Asian Development Bank, which co-chairs the FIC together with the EBRD, some companies simply use the FIC to brag about their latest accomplishments. "They spend the whole time banging their chests, talking about how good their programs are," he said. Wermert attended the December 5 meeting and said the foreign investors missed an opportunity to build trust with the government. "They would have made a more favorable impression on the

government," he said, "if they had talked about Kazakhstan's needs and future development, rather than their own company's parochial plans."

THE LOCAL-CONTENT ISSUE

¶6. (SBU) The issue before the Foreign Investors Council on December 5 was local content, i.e., the percentage and value of Kazakhstani participation in foreign investment projects, including staffing and subcontracts for goods and services. All ma\${d6FH{el A). Nevertheless, the December 5 FIC meeting made it clear that the government expects more to be done to promote local companies, build local capacity, and develop local expertise.

PRESIDENT LASHES OUT

¶7. (SBU) According to ConocoPhillips's Nick Olds, who attended the FIC on December 5 with ConocoPhillips CEO Jim Mulva, President Nazarbayev was more active, directive, and critical than during any of the previous six meetings. Olds said that Nazarbayev lamented the low level of local content in Kazakhstan's mega-projects, then he went around the table, looked his ministers in the eye, and

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pointed his finger in turn, saying, "This is what I want you to do: boom, boom, boom."

¶8. (SBU) President Nazarbayev claimed that from January through September, Kazakhstani content in foreign purchases of goods and service did not exceed 15% of the total procurement value. Nick Olds and Shell's Country Director Campbell Keir, who also attended the meeting, said Nazarbayev was outraged and called the situation unacceptable: "Obviously," he said, "this state of affairs does not satisfy the state, the oil companies, or Kazakhstani producers." (NOTE: Unfortunately, the data provided to President Nazarbayev were incomplete and therefore inaccurate. For example, the three largest investors in Kazakhstan -- Tengizchevroil, Agip KCO (Kashagan), and Karachaganak KPO -- were not included in the list of companies that use local subcontractors and employ local staff, despite the fact that, combined, they purchase 43% of all goods and services in Kazakhstan. END NOTE).

¶9. (SBU) According to Olds and Keir, Nazarbayev pointedly reminded the foreign investors present that they have a contractual obligation to hire Kazakhstanis, invest in social projects, and promote the development of new industries, such as petrochemicals. Nazarbayev said that increasing Kazakhstan's share in foreign investment projects should become the government's number one priority, although he did acknowledge that Kazakhstani producers must provide competitive, quality services and products to meet the demand of foreign companies.

¶10. (SBU) Nazarbayev said that oil and mining companies in Kazakhstan purchase \$18 billion in goods and services annually, including \$10 billion in services. He complained, however, that Kazakhstani companies are often unable to participate in the bidding processes. "Kazakhstani producers do not have information about the dates, terms, and conditions of tenders for the purchase of goods and services," said Nazarbayev. "If we knew what a foreign investor plans for the next year, or second or third year, we could prepare our companies for it. Besides," he added, "some tenders are conducted, say, in London. It's an absolute disgrace!"

KMG SINGLED OUT FOR CRITICISM

¶11. (SBU) Foreign investors were not surprised to find themselves criticized for not meeting the government's local content expectations, but they were surprised to see national oil company KazMunayGas singled out by Nazarbayev for "poor promotion of local interests in joint ventures with foreign investors." Every year, the government reviews and approves KMG's plans for procurement, capital expenditures, and exploration and production, to ensure that they meet local content requirements. According to Nazarbayev, however, "KazMunayGas has done nothing, or has just worked very poorly, and does not do enough to increase Kazakhstani interests in joint projects." He ended emphatically, "The situation must be rectified immediately."

FOREIGN INVESTORS RESPOND

¶12. (SBU) The reaction of foreign investors to the government's criticism was muted, partly because the data cited by the president were incomplete and partly because the companies themselves agree with the president on the need to increase investment in local staff and subcontracts. Shell's Keir said, "Increasing local content in the purchasing of goods and services is a priority for us." He added that local suppliers often know the domestic market better and

can offer more beneficial contract terms and supply deals. "It's just good business," he said. Keir noted, however, that it is not always easy to meet the government's local content requirements, simply because there is no single, uniformly-applied formula for calculating the value and percentage of local content in a given procurement.

¶13. (SBU) Alexander Mashkevich of the Eurasian Natural Resources Corporation noted that domestic suppliers must be competitive and

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able to meet international standards on quality and timeliness if they expect to provide goods and services to Kazakhstan's major investment projects. Mashkevich called for a new government program to coordinate the quality, quantity, cost, and diversity of local suppliers, a proposal that was not immediately endorsed by other foreign investors.

IMPLICATIONS AND NEXT STEPS

¶14. (SBU) Nazarbayev ordered that an independent committee be established immediately to increase the local content of products and services in Kazakhstan. He signaled the government's determination to enforce local content provisions, saying, "The government should monitor the fulfillment of obligations on local content, increase responsibility for noncompliance with contract terms, and set up a system of government control over the subsoil users' activities on this issue."

¶15. (SBU) Ominously, Nazarbayev also ordered the government's new committee to review all existing subsoil contracts in order to establish or increase local-content quotas and identify local Kazakhstani producers and suppliers. According to press reports, Nazarbayev instructed the Ministry of Labor and Social Protection to arrange a system of assigning and distributing quotas to regions (oblasts) in order to monitor the extent that regions meet their quotas.

¶16. (SBU) The next meeting of the Foreign Investors Council will be held on June 12, 2009, in the city of Kostanai. The theme will be "Alternative Sources of Financing for the Continued Economic Development of Kazakhstan in the Context of Global Changes."

¶17. (SBU) COMMENT: American investors who attended the December 5 meeting were pleasantly surprised by Nazarbayev's balanced, businesslike approach to promoting local content and his direct, personal engagement with the companies and his Cabinet. Many observers commented that Nazarbayev was much more active and involved in this meeting than in previous sessions of the Foreign Investors Council. In particular, investors who attended the meeting appreciated Nazarbayev's statement that Kazakhstani suppliers must become more competitive and produce quality products that meet international standards. The president's passion for local content is partly a result of the financial crisis, which has hit local suppliers hard and forced even large, diverse, state-supported companies such as KMG to lay off as much as 10% of their workforce. Although he criticized foreign companies for their allegedly low local content, Nazarbayev also appealed for their support during these troubling times: "I do hope that your companies will support Kazakhstan's economy during this difficult period," he said. "I have asked you before and I am asking you again to provide social protection for the people during this period and preserve and create jobs."

¶18. (SBU) COMMENT CONTINUED: American investors were not alarmed by Nazarbayev's call to review and revise the local content provisions of existing contracts, mainly because the companies can in fact demonstrate a high level of local content, the president's claims notwithstanding. They do, however, expect increased government scrutiny and closer monitoring of future procurement and hiring decisions. Ultimately, government poking and prodding will not be necessary or even useful. The companies themselves understand the economic and political business case for increased local content, but they believe the best way to achieve that is through improving the competitiveness of local suppliers, not through government mandates and quotas. END COMMENT.

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